

# DEALING IN DEBT

By Richard W. Hamlin

**W**ith delays to the military buildup, debt and unpaid invoices are now an unfortunate economic reality for many Guam businesses.

Creditors and debtors alike should be comfortable managing their debt, understanding that it may mitigate losses, present new opportunities, or even conceal danger.

Promissory notes are negotiable instruments, enforceable more like a check than a regular contract, containing a clear specification of the dollar amount owed, the promised payment schedule, and any applicable interest rates. Personal guaranties may also accompany the note, contractually extending the note holder's collection reach to individuals beyond the original debtor. A failure to pay may also reach beyond the note, triggering cross defaults on other unrelated loans. Executing a promissory note creates a new obligation, independent of any previous business contract issues or invoice disputes. The note holder may thus sue directly for enforcement on the note, avoiding lengthy and contentious court litigation. Likewise, promissory notes also may present a veneer of legitimacy to an inflated or fraudulent underlying debt, posing a potential risk to debtors or unsecured creditors.

Perhaps the most powerful aspect of a promissory note lies in the note holder's ability to independently sell or assign it to other parties. Promissory notes are generally not considered securities for regulatory purposes, allowing corporate debt to be marketed far more easily than stock. As a general rule, promissory notes in small, distressed businesses are worth no more than the collateral by which they are secured. However, if an interested buyer is available, promissory notes may have a value independent of their economic risk. Parties related to the debtor, such as a parent corporation, or even a wealthy uncle, may be interested in buying the note so as to write off or convert the debt. Parties in conflict with the debtor, such as the plaintiff in a suit against the debtor, may also be interested



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in purchasing the debt for their own advantage. Interesting things occur when a note is sold to the debtor's competitor.

Complementing a promissory note with a comprehensive security agreement and Uniform Commercial Code-1 (UCC-1) financing statement greatly enhances a creditor's likelihood of payment, the note's marketable value, and the debtor's room to negotiate favorable repayment terms. The first creditor to properly record the lien documents will have his or her interests protected to the extent of the collateral value, and will enjoy an advantage over all other competing creditors. Unsecured creditors should expect to receive little following a debtor's bankruptcy.

Debtors may also protect their assets by granting security interests to tame creditors or confederates, and to the detriment of unsecured or late-filing creditors. Generally, asset foreclosure can be conducted quickly and outside of court. In extreme circumstances, a lienholder may keep the collateral as satisfaction for the debt, even when the collateral value far exceeds the underlying debt. Such sharp dealing can turn debt into profit for a predatory creditor or a self-dealing debtor.

Liquidation usually should be (and can be) avoided, as an operational business is worth more as a package than as the sum of its assets. This is particularly true of Guam businesses, where ownership investment in an operating enterprise may serve as a basis for a U.S. visa. Given the flexibility of promissory notes and security interests, it is not hard for an applicant to meet investor visa requirements using assigned debt and minimal cash investment. The possibility of foreign investment presents a compelling reason for an enterprise to restructure its debts, especially if there is the possibility of a complete asset transfer, spin-off business or equity conversion.

Before foreclosing or filing bankruptcy, companies should understand implications of different debt structures, including the positions and motivations of those who stand to gain or lose. A good business lawyer can restructure debt to provide new options, promote client interests and obtain favorable outcomes for all concerned.

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